

CROSS-BORDER ACQUISITIONS: A CASE OF AN INDIAN ENGINEERING FIRM

ABDUL WAJID¹, HARJIT SINGH² & ABDUL AZIZ ANSARI³

¹Research Scholar, Department of ACCF (Amity College of Commerce and Finance), Amity University, Noida

²Associate Professor, Department of ASB (Amity School of Business), Amity University, Noida

³Head of the Department, Department of Commerce and Business Studies, Jamia Millia Islamia, New Delhi, India

ABSTRACT

Indian engineering industry has shown an outstanding growth over the last few years largely driven by infrastructure and industrial production. This sector has a strategic importance in the Indian economy as it is the largest segment in the Indian industries. There has been a spate of Cross-border acquisitions in nearly every Indian industry including engineering industry; though, acquisitions across borders by Indian engineering firms have not received much attention from academicians. The present study is an attempt to fill the gap in existing literature by undertaking an in-depth analysis of motivations behind these acquisitions and how shareholders of acquiring firms perceive these acquisitions. This study takes a case of cross-border acquisition by an Indian engineering firm; Precision Camshaft Limited. Precision Camshafts Limited is an auto component manufacturer and a leading supplier of camshafts to passenger vehicle manufacturers. Currently, it has 150 varieties of Camshafts with a well-established presence across different geographies. It generates most of its revenue from exports in Europe, Asia, North America and South America and it also has existence in other countries. In March 2018, it acquired a German firm; MFT (Motoren und Fahrzeug Technik GmbH). We used event study methodology to analyze the impact of announcement of its acquisition news to the general public, results suggest that the shareholders of Precision Camshafts Limited responded positively to its acquisition of MFT as Cumulative abnormal returns are significant at 5% level. Our analysis also suggests that there are three main motivations behind cross-border acquisitions by Indian engineering firms; technological up-gradation, increasing customer base and to become a global brand.

KEYWORDS: Indian Engineering Firms, Auto Component Manufacturers, Cross-Border Acquisitions & Precision Camshafts Limited

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INTRODUCTION

Corporate restructuring through mergers and acquisitions has emerged as an important strategies worldwide, this trend has mainly seen in India during 1990's and it is well established (Kumar 2000; Bhoi 2000). There has been a spate of Cross-border acquisitions in nearly every Indian industry including engineering industry, though, acquisitions across borders by Indian engineering enterprises have not received much attention from academicians. Engineering industry has the largest segment in the Indian industries as per IBEF (Indian Brand Equity Foundation) reports. This industry comprises various subsectors and often subdivided into two main categories; heavy engineering and light engineering. However, subsectors include, but not limited to iron and steel, other metals, mechanical and electrical machineries and equipment, automobile equipment, appliances, arms and ammunitions, instruments and other related items. Recently many cross-border acquisitions by Indian engineering

firms are reported, but there is scarcity in literature related to the importance of these acquisitions as well as the impact of these acquisitions on shareholder's wealth. This study is an attempt to fill the gap in existing literature by undertaking an in-depth analysis of the outcome of these acquisitions and how shareholders of acquiring firms perceive these acquisitions. The present study takes a case of cross-border acquisition by an Indian engineering firm; Precision Camshaft Limited. Precision Camshaft limited is an auto component manufacturer and a leading supplier of camshafts to passenger vehicle manufacturers.

Lately, there has been a tremendous increment in value of outbound acquisitions by Indian auto component manufacturers which can be seen in table 1. According to Venture Intelligence, there have been 13 M&A deals (inbound and outbound) by Indian auto component manufacturers in the calendar year 2017. While till March 2018, four M&A deals (outbound and inbound) were carried out by auto component manufacturers.

Table 1: Cross-Border Acquisitions by Indian Auto Component Makers

Years	Amount(in \$ million)	No. of Deals
2015	2.8	4
2016	76.1	6
2017	614.16	4

Source: Venture Intelligence

LITERATURE REVIEW

(Hitt & Pisano, 2003) compared foreign acquisition, strategic alliance and joint venture as a strategy to expand firms operations outside national boundaries, and concluded that cross-border acquisitions are by far the best way as it offers significant opportunities for firms to diversify its activities in other geographies, helps in learning new perspectives and provide access to important resources.

(Ojanen, Salmi & Torkkeli, 2008) analyzed the cross-border acquisition phenomenon by Finnish engineering consulting firms. They focused specifically on technological engineering and consulting business. Their study concluded that market and product extension are most important factors for firms considering cross-border acquisitions.

(Nayyar, 2008) analyzed the overseas acquisitions and FDI from India. They found that most of the foreign acquisitions by Indian corporate happened in industrial countries, and much of the FDI was done in manufacturing activities.

(Uddin & Boateng, 2009) examined the short-run performance of U.K firms engaged in cross-border acquisitions during the years 1994 – 2003. Event study methodology was utilized to analyze the short-run performance of acquirers. The study reported that U.K acquirers did not experience significant positive abnormal returns surrounding announcement of cross-border acquisitions.

(Kale, 2009) analyzed the primary motives of overseas acquisitions by Indian firms. He expounded that Indian companies engage in cross-border acquisitions to make new customers, to gain new technology & products and to acquire management talent. He also suggested that Indian firms are able to carry out foreign acquisition quite well in meeting their objectives and creating shareholders wealth.

(Wang & Liao, 2009) analyzed cross-border acquisitions by Western Europe firms. They found evidence that cross-border acquisitions create wealth for shareholders. They further stated that shareholders wealth is affected by a form

of payment, acquirers leverage and firm size.

(Gubbi et al, 2010) suggested that overseas acquisitions by emerging economy firms assist them in acquiring resources that are difficult to trade and develop. Therefore, cross-border acquisitions help these firms to access these resources they further suggested that the intensity of benefits is higher when targets are located in advance and developed countries.

(Rani, Yadav & Jain, 2013) examined the abnormal returns to shareholders of acquiring firms surrounding acquisitions of domestic mergers and acquisitions. They reported a significant CAAR for 5 days event window, but when considered 19 days event window post acquisition, they found significantly negative abnormal returns for acquirers.

(Chidambaran et al, 2017) studied the acquisition activity by Indian firms. They suggested that younger firms, firms with excess cash, low leverage firms and firms which are relatively overvalued are more likely to take the route of acquisitions. They further suggested that competition is an important factor behind cross-border acquisitions by Indian firms.

RESEARCH METHODOLOGY

Objective of the Study

The primary objective of the study is to analyze the cross-border acquisition activities by Indian engineering industry, specifically, auto component manufacturers. While the secondary objective is to analyze the impact of announcement of cross-border acquisition by Precision Camshaft Limited.

Data Collection

Secondary data is used in present study. The data is gathered from annual reports of Precision Camshafts Limited, web sources, BSE, Yahoo finance, published research papers and News articles.

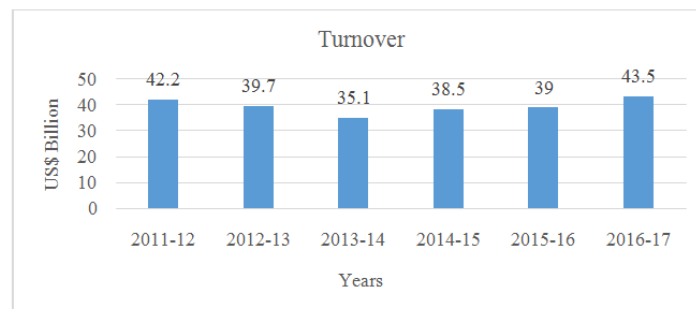
Tools and Techniques

Event study methodology is employed to analyze the short-term abnormal return to the shareholders of Precision Camshafts Limited surrounding its acquisition announcement of Motoren und Fahrzeug Technik GmbH (MFT).

Motives and Rational of Cross-Border Acquisitions by Indian Auto Component firms

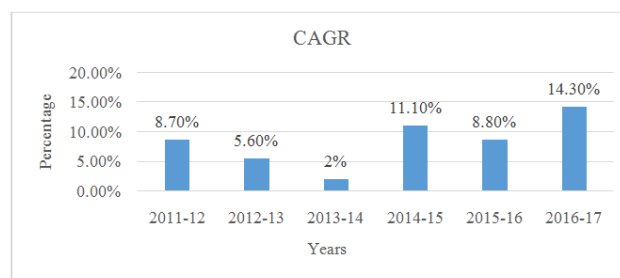
One of the important rationales of overseas acquisitions is, that most of the auto component firms have products which are less likely to become obsolete by technological disruption as expected due to a change in the global automobile industry and it's shifting towards electric vehicles. Technological up-gradation and to create global platforms are also one of the reasons for overseas acquisitions. Overseas acquisitions in auto component firms are also motivated for shareholders and stakeholders interests. As pointed out by Motherson Sumi chairman Vivek Chand Sehgal, "we are always looking into possibilities for acquisitions. They are at the behest of customers and to the best interest of our stakeholders" ("Indian auto component firms on a shopping spree", 2018). New evolution in technology is also a reason for overseas acquisitions. As stated by Tata Auto Comp System (TACO) managing director Ajay Tandon. "The evolution of electric, hybrid and connectivity technologies interest him, hitting at his new target" ("Tata Auto Comp systems eyes more foreign acquisitions in the quest to expand, 2017").

Due to increasing domestic demand and its location proximity with important Asian markets, India's auto component market has become a sourcing hub ("Auto Components Manufacturing in India: Robust Investment Outlook, Growth Potential, 2018"). As can be seen in Graph 1, the combined turnover of auto component firms has touched the US \$43 billion, and experts suggest that it may go up to the US \$115 billion in 2020-21. There has been an increasing trend in the turnover of these firms from the year 2013 till 2017. The Compound Annual Growth Rate (CAGR) of these firms also showed a positive trend and it increased tremendously in the year 2016-2017 as can be seen in Graph 2.



Source: www.india-briefing.com

Graph 1



Source: www.india-briefing.com

Graph 2

Background and Profile of Precision Camshafts Limited

Precision Camshafts Limited incorporated in the year 1992, and a few years later in 1997, a private equity investor "Common Wealth Development Corporation" from the United Kingdom invested in this company which helped it in expanding its machine shop and other operations. Since then it has started taking inorganic route of acquisitions to grow in the industry. In the year 2016, it released its IPO and subsequently listed on BSE and NSE. Precision Camshafts Limited has earned many awards and accolades during its journey of becoming a leading manufacturer and supplier of Camshafts. Currently, it has 150 varieties of Camshafts. With a well-established presence across different geographies and presence in low-cost manufacturing destinations like China Precision, Camshafts Limited has acquired 8-9% market share globally in passenger vehicle Camshafts market. It generates most of its revenue from exports in Europe, Asia, North America and South America.

Precision Camshafts Limited is pursuing acquisitions in Europe to strengthen its customer base and to add niche products in its portfolio. It believes that three areas will drive its future growth;

- Enhanced focus on value-added machined camshafts.
- Product diversification

- Acquisitions

Precision Camshafts Limited rely on inorganic route to grow in the industry which can be seen in table 2 below. Its recent acquisitions comprised two overseas firms, namely EMOSS from Netherland and MFT (Motoren und Fahrzeug technik Gmbh) from Germany and one domestic firm MEMCO Engineering Private Limited based in Nasik, India.

Table 2: Recent Acquisitions by Precision Camshafts Limited

Years	Company	Country
2017	MEMCO Engineering Private Limited	India
2018	EMOSS	Netherland
2018	MFT(Motoren und Fahrzeug Technik Gmbh)	Germany

Source: website of Precision Camshafts

Rationale of Acquisition of MFT (Motoren und Fahrzeug Technik Gmbh)

Precision Camshafts Limited has acquired 76% stake in MFT through its wholly owned subsidiary PCL Holding B. V in all cash deal, though, the deal value remains undisclosed. The agreement further gives rights to Precision Camshafts Limited to acquire the remaining stake in the year 2021. In an interview with Economic Times, Precision Camshafts Limited Chairman and Managing Director Yatin Shah stated, that the acquisition with German firm is value accretive and will open up synergistic opportunities through new products and it will also help in establishing Precision Camshafts Limited as a global brand. He further stated that MFT will help it in complementing its relationship with current OEM's and expanding its customer base. MFT is said to have a long-term relationship with Volkswagen, Suzuki, Audi, Hatz and Opel. While Precision Camshafts Limited caters to Ford Motors, Toyota, Hyundai, Porsche and General Motors. The acquisition of MFT will help it to expand its customer base as it will be able to supply its components to companies which it was not catering earlier.

Short-Term Abnormal Returns to Shareholders of Precision Camshafts Limited Surrounding its Acquisition Announcement of MFT

We used Event Study Methodology (ESM) to analyze the impact of announcement of the acquisition on stock prices (Brown and Warner 1980; Mackinlay 1997; Kothari and Warner 2007; Rani 2013) of Precision Camshafts Limited. ESM is widely used in finance literature to analyze the change in stock prices due to any corporate event (McWilliams and Siegel 1997). The underline issue in event study is to analyze the market returns of securities of firms involved in any corporate event like merger and acquisition, dividend announcement and stock split, in order to measure the reaction of the market (Kliger and Gurevich, 2014). It is assumed that effect of any corporate event of a company reflects directly on its share prices.

First, we define an event, the day of announcement of acquisition to the public. Day 0 is defined as announcement day, 23rd March 2018 and verified from Precision Camshafts Limited website. ESM is employed to measure the impact on short-term stock prices of Precision Camshafts Limited surrounding its acquisition announcement of MFT. The abnormal returns of (-5, 5) days event window were analyzed. Adjusted closing price and index data were taken from yahoo finance and BSE Sensex. An estimation period of 179 days was used for estimation, starting from 200 days prior to the announcement of the acquisition to 21 days prior to the acquisition (Uddin, 2009).

The market model is used to estimate the returns;

$$R_t^i = \alpha_i + \beta_i R_t^m + \varepsilon_t^i$$

R_t^i is the return of Precision Camshafts Limited for period t.

R_t^m is the market return for period t.

α_i & β_i are model parameters.

\mathcal{E}_t^i Signifies error term.

The Abnormal return for Precision Camshafts Limited at period t is calculated as:

$$AR_t^i = R_t^i - (\alpha_i + \beta_i R_t^m)$$

AR_t^i is the Abnormal return of Precision Camshafts Limited for period t

Cumulative abnormal return is defined as:

$$CAR_{s,t}^i = \sum_{\tau}^t AR_{\tau}^i$$

The results of event study of Precision Camshafts Limited is reported in table 3. The intercept is -0.00158, the standard error is 0.00230, slope (beta) is 1.235 which shows Precision Camshafts Limited has more than average risk which is understandable, as it is a high growth firm. The r-square is 0.712 which means that the model is explaining 71.2% variation in returns of Precision Camshafts Limited surrounding the acquisition announcement with MFT. The Cumulative abnormal return to shareholders of Precision Camshafts Limited increased significantly and reached up to 10.62% in five days event window. The results are significant at 5% level up to the fourth day of the acquisition announcement, so it can be said that the shareholders of Precision Camshafts Limited responded positively to its acquisition of MFT.

Table 3: Event Study of Precision Camshafts

Days	Ars	Cars	T-Test
5	-0.18%	10.44%	-0.077
4	5.85%	10.62%	*2.542
3	2.50%	4.77%	1.088
2	3.71%	2.26%	1.612
1	-4.97%	-1.45%	*-2.157
0	4.18%	3.52%	1.817
-1	2.14%	-0.66%	0.930
-2	-0.99%	-2.80%	-0.428
-3	-0.63%	-1.82%	-0.275
-4	-1.79%	-1.18%	-0.776
-5	0.60%	0.60%	0.262

CONCLUSIONS

There has been a remarkable expansion of Indian firms across its national boundaries. Their presence is seen mostly in developed markets as expansion in industrial countries offers many advantages to emerging market economy firms. Almost every industry from India has some form of expansion in foreign countries through modes like strategic alliance, joint venture, merger and acquisitions. Indian engineering industry has shown an outstanding growth over the last few years, largely driven by infrastructure and industrial production. This sector has a strategic importance in Indian economy. There has been a notable growth in engineering exports from India which grew to the US \$76,204.38 million in the financial year 2018.

The increase in exports from engineering sector can be partly attributed to the foreign acquisitions by Indian engineering firms. The present study is undertaken for two motives. Firstly, we explored the acquisitions activity by Indian engineering firms, specifically auto components manufacturers. Secondly, an in-depth analysis of an auto component firm Precision Camshafts Limited is done. Incorporated in the year 1992, it is a leading manufacturer and supplier of camshafts in India and has relied mainly on acquisition as a strategy to grow. In the year FY 2018, it has acquired two companies outside India as can be seen in table 2. We analyzed the impact of its acquisition of Germany based firm MFT. We used event study methodology to analyze the short run abnormal returns to the shareholders of Precision Camshafts Limited. The results of the analysis showed that the shareholders perceived this acquisition as a good news as can be seen in table 3, the cumulative abnormal returns reached up to 10.62% during 5 days event window.

Management Implications and Future Direction

Recently a spate in cross-border mergers and acquisitions by Indian engineering firms is reported. Indian engineering firms have been taking these inorganic routes mainly to acquire new technologies, extend customer base and to become a global brand. The present study reports that cross-border acquisition deals by Indian engineering firms are not just increasing the customer base or assisting in acquiring new technologies, but also increase shareholders wealth, which is a primary motive for every organization.

The results of the study offer a roadmap to corporates, academicians and practitioners for designing and redevising their expansion drive across national borders. The same analysis can be carried out by taking a large sample size of Indian engineering firms, as not much work till date has been done on the motivation and outcome of cross-border acquisitions by Indian engineering firms.

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